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# TRIGGERING THE ETHIOPIAN COMPANY LAW RE-ENGINEERING ALIGNED WITH BENEFITS AND BURDENS OF THE FOUNDER TO FORM A SHARE COMPANY

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## ABSTRACT

The study examines about the benefits, burdens, and liabilities of the founder provided under a Company Law of Ethiopia. The founders of a share company are acting for a company not yet established. Consequently, the occurrence of conflict of interest is inevitable. There are also legal persons owned by the founders in which they are taking part at a company under formation. For this reason, the Company Law seems neglected to be re-engineered with appropriate mechanisms to make the founders and other persons answerable for their actions. Thus, this paper try to say on the legal dysfunction of Ethiopian Company Law through analysis of both domestic and other countries' laws in tandem with the founders and contemporary developments of founder's juridical acts. Therefore, the study reveals that there is a distinctive gap between the Company Law of Ethiopia and the overall new development of juridical activities of the founders. As a result, the writer recommends that the law maker need to give special emphasis on the issues of the founders in the legal and policy reform of Company Law of Ethiopia.

**Key Words:** Founder, benefits, burdens, liabilities, legal re-engineering, a company under formation, company law.

## Introduction

A share company appears due to the efforts of prominent persons known as founders. Overwhelmingly, the benefits and burdens of the founders provided under the law are just to facilitate the genesis of a share company that would be capable to proof the inherent position of the founder. In any case the founders shall act in line with the mandatory and default provisions of the company law.

The Company Law of Ethiopia provides mandatory limits of benefits and burdens for the founders in which one can acclaim and be answerable, accordingly. In general, the Ethiopian Commercial Code and various legislations of Ethiopia that regulate the behaviors of the founders of the share company other than financial laws are not enough to protect the interests of the public.

The duty of disclosure, fiduciary duty and consequences in-kind contribution valuation procedure (after repeal of the rule under the Commercial Code under the



newly passed legislations on trading activities' registration and licensing) have lost place direct consideration under the Company Law of Ethiopia.

There is no mechanism to check whether the founders are convicted or not within certain period of time. These conditions may probably justify their business ethics for protection of the public interests. Furthermore, the National Bank of Ethiopia checks the founders whether they publish the 'Notice of Intention' or not which settle the objection of any third parties lodged to such organ to the effects of the above instances.

Therefore, founders are liable for their actions based on the law or contract either civilly or criminally. In fact, general provisions on Law of Obligations may solve the issues in tandem with civil liabilities at this juncture. However, the special nature of juridical activities have been performed by the founder at a company under formation or before registration of a share company necessarily need to be treated under the special parts of the company law.

## **1. The rights of the founders**

### **1.1. The right to get the legal status of the founder**

The founder is a person who undertakes to form a company with reference to a given project and setting a company in motion to accomplish company's designed purposes.<sup>1</sup> Thus, when a share company is formed among the founders themselves, in which such founders signed the memorandum of association and subscribe the whole of the capital, they shall have the legal status of the founders.<sup>2</sup> However, in case when a share company is formed via public subscription different categories of persons will assume the status of the founder.<sup>3</sup> As a result, those persons who sign the prospectus, bring in contributions in kind or allocated a special share in the profits shall have such right.<sup>4</sup> In addition, any person who has initiated plans or facilitated the formation of the company shall also claim the same right.<sup>5</sup>

### **1.2. The right to get the profits allocated to the founders**

In India the founders of the company may be remunerated either by the commission of share subscription or an aggregate lump sum from the profits of the company.<sup>6</sup> If there is a contract of remuneration paid to the promoter, any other suitable mechanism will follow to effect the payment as per the constituent document.<sup>7</sup> However, in Ethiopia the founders may reserve personally to themselves a profit of a company in memorandum of association.<sup>8</sup> This profit is a share, which shall not exceed one fifth of the net profits in the balance sheet.<sup>9</sup>

Consequently, there is no any other advantage to be provided in the memorandum of association.<sup>10</sup> Furthermore, such advantage is personal to the founder, however; there is no founder share may be issued.<sup>11</sup>

### **1.3. Reimbursement right**

In other jurisdiction the founding persons entitled reimbursement of the preliminary expenses incurred for the formation of the company.<sup>12</sup> Hence, in Ethiopia founder can claim for expenses or costs incurred for company under formation.<sup>13</sup>



Therefore, the company shall takeover commitments from the founders and refunds the founders with all the expenses made by the same.<sup>14</sup> However, the company may refund such expenses upon the fulfillment of the following two conditions. These are commitments and expenses of which they were necessary for the formation of the company and approved by the general meeting of the subscribers.<sup>15</sup>

## **2. Duties of the founders**

The founder owes certain obligations to the company forming in which a duty of good faith is owed in all dealings with the incipient company.<sup>16</sup>

### **2.1. Fiduciary duty**

The Company Law of Ethiopia does not deal this duty directly. However, there are provisions of the law acclaim for such duty in the country. For instance, the Criminal Code of FDRE requires that the founder of the company who is assigned on the property rights of other persons not to act in fraudulent misrepresentation.<sup>17</sup> In addition, he founder may not give a vote in her or his capacity as the shareholder or as a proxy of other shareholder on the resolution approving her or his special share in the profits of the company.<sup>18</sup> The law goes on to say that such rule will apply for resolution approving the valuation of the contributions in kind.<sup>19</sup>

### **2.2. Disclosure**

The founder shall faithfully disclose all facts relating to the property transferred and contract entered to the future company.<sup>20</sup> Anyone who is occupying the position of the founder is under a duty to display all facts as to juridical activities done by the founder to all shareholders. Hence, disclosure is the key duty of the founder.<sup>21</sup>

The duty of the founder cannot depend on a contract because at the time the promotion begins the company is not formed and so cannot contract with the founders.<sup>22</sup> Therefore, the founders' duties must be as the same as that of a person acting on behalf of another individual without a contract.<sup>23</sup>

The Criminal Code circumscribes fraudulent misrepresentation which relates to an offence on economic interests of third parties committed by the founder.<sup>24</sup> Thus, in such case the founder shall not conceal material facts in relation to the property rights to deal at the formation stage of the company.<sup>25</sup>

Even if there is no clear provision on such duty under the Commercial Code, for instance the Code provides about the issue of approval of the costs and expenses made by the founder of the company by the general meeting with sufficient cause as per sub Art. 2 of Art. 308 of the Commercial Code. Thus, there is a duty on the side of the founder to display facts in relation to expenses and costs incurred for sound operation of the company under formation.



### **2.3. The duty to stipulate in kind contribution**

The founder is under a duty to evaluate in kind contribution as per the Commercial Code. A member who contributes in kind shall have a duty to file a report made and sworn by experts appointed by the Ministry of Commerce and Industry.<sup>26</sup> However, this rule is repealed by new law. Therefore, founders shall to stipulate the valuation of contribution in kind in the memorandum of association.<sup>27</sup> The Code also provides the way out for the acceptance of such valuation of contribution in kind under Art.315 sub Article 3. Hence, the directors and auditors shall verify such valuation within six months period after the formation of the company. More importantly, they may review the valuation and such value representation of shares shall be deposited in a company and may not be assigned up until verified.

Admittedly, shares representing contribution in kind shall normally fully to be paid before the registration of the company.<sup>28</sup> Thus, such shares shall be kept to the company and may not be separated from the counterfoil and be negotiated before two years from registration of share companies.<sup>29</sup>

### **2.4. The duty to sign the basic documents of the company**

Founders or members of a business organization shall sign the memorandum and articles of association at the Documents Authentication and Registration Office.<sup>30</sup> These documents shall be drawn according to standardized samples of memorandum and articles of association sent to the same office by the registering office.<sup>31</sup> The duty to sign these basic documents of the company is done before applying for commercial registration.<sup>32</sup>

### **2.5. The duty to have promotional license**

The founders of public subscription call vast capital from the public. Thus, they are representing the non existing company. Founders in order to begin formation efforts of share companies have operated inside the market. The founders enter into contracts with third parties. The founders need to produce a license proving their status. Hence, third parties will be informed about persons acting on behalf of a company under formation.

The Commercial Code is silent about such issue, however, the new law on commercial registration introduces that the founders who want to establish a share company via public subscription as per Art. 317 seq. of the Commercial Code shall get promotional license.<sup>33</sup> Therefore, the founders of a share company in order to start the formation of the company shall in advance obtain the written permission of the registering office (the Ministry of Trade).<sup>34</sup>

The promotional license is not given for all kinds of share companies. First, the law excludes share companies formed by founders per se. Second, there has to be a difference between legal founder and contractual founder. The prior covers those founders who sign the prospectus, contribute in kind contribution and participate in the initiation of the plans or facilitate the formation of share companies according to



Art. 307 (3) and (4). However, the latter covers those founders who are to be allocated a special share in the profits. The issue is that to grant the promotional license; the law does not differentiate exactly between those persons who are called promoters (in the sense of organizers of a share company) and founders.

## 2.6. The duty to publicize a notice of intention

The duty to publicize a notice of intention is not required by law for all types of formation process of share companies. The founders are under obligation to publish their intention to form a share company of banking business.<sup>35</sup> Thus, upon filing the application to the National Bank that the founders shall at least once a week publishes a notice of intention to engage in banking business.<sup>36</sup> The founders shall to do this activity for a period of four consecutive weeks in a form prescribed by the National Bank in widely circulating newspapers.<sup>37</sup> This activity will help the NBE to decide over the integrity of the founder to establish a share company in banking, insurance or other financial institutions.

Any person who objects the involvement of any of the founders as a shareholder in the proposed bank may submit his objection in writing.<sup>38</sup> Any person shall present an application to the National Bank with supporting evidence in no later than thirty days starting from the date of the last publication of intention to form banking business.<sup>39</sup> The National Bank shall initiate an inquiry into such objection. The results of such an inquiry shall be published and be considered in deciding whether to issue the license or not.<sup>40</sup> The same duty holds true for insurance business.<sup>41</sup>

In French Commercial Law there is a duty of the founder to publish a notice of intention for all kinds of business. The founders shall publish a notice in accordance with the conditions laid down by *Conseil d'Etat* decree.<sup>42</sup> Persons who have forfeited the right of directorship or management of a company or who are disqualified from holding these offices may not be founders.<sup>43</sup>

## 3. Liabilities of the founders

The founders shall be fully jointly and severally liable to third parties in respect of commitments entered into for the formation of the company.<sup>44</sup> All persons who have acted in the name of the company before its registration in the commercial register shall be similarly liable.<sup>45</sup> Where the company is not established for whatever reason, the subscribers shall not be liable for the commitments or expenses made by the founders.<sup>46</sup>

The founders shall be held liable jointly and severally to the company and third parties for any damage in relation to the following three heads of duties. These are, viz.: the subscription of the capital and the payments for the formation of the company, putting valued contributions in kind as provided under Article 315 of the Code (in fact this duty is repealed by Pro.No.686/2010, Commercial Registration and Business Licensing Proclamation) and the accuracy of statements made to the public in respect of the formation of the company.<sup>47</sup> There is period of limitation to present



such claims for damage and it shall be barred after five years from the date when the aggrieved party knew of the damage and of the person liable, and there shall be absolute limitation after ten years from the date when the act complained of took place.<sup>48</sup>

Concededly, no company shall remain in business more than six months after the number of members is reduced less than five persons is reduced.<sup>49</sup> Therefore, every member aware of such reduction shall be personally liable for the debts contracted thereafter.<sup>50</sup> Furthermore, the Code gives discretionary power for the court to decide over the fate of the company of which members are reduced in number below the legal minimum, and a company which lacks the prescribed organs.

Consequently, the court may order the winding-up of such company on the application of a member or creditor.<sup>51</sup> On top of such decision, the court may adjourn its decision upon such term as it thinks fit to permit of the reorganization of the company and order such conservatory measures as may be necessary.<sup>52</sup> Before registration of companies shares may not be issued.<sup>53</sup> If the reverse is happened such shares shall be null and void.<sup>54</sup> However, liabilities arising under such legal consequences shall not be affected.<sup>55</sup>

The FDRE's Criminal Code and other enabling legislations that can regulate the behaviors of the founder have provided offences that would be committed by such founder. For instance, the Criminal Code under its Art.692 (1) provides an offence that would be committed by the founder. The founder is punishable with simple imprisonment, or, according to the gravity of the case, with rigorous imprisonment not exceeding five years, and fine for misleading statement he or she made.

Further, under the Commercial Registration and Business Licensing Proclamation there are penalty provisions on persons participating in the formation process of share companies. If the founder has intentionally got himself registered in the Commercial Register, she or he shall be punished with fine from Birr 60,000 (sixty thousand) to Birr 120,000 (one hundred twenty thousand) and with rigorous imprisonment from 7 (seven) to 12 (twelve) years.<sup>56</sup>

In case of banking industry any person (founders are also included) who contravenes or obstruct the provisions of the proclamation on banking business or regulations or directives issued to implement such proclamation shall be punished with a fine up to Birr10,000 (ten thousand) and with an imprisonment up to (3) three years.<sup>57</sup>

The newly amended anti-corruption law is to probe private sector in Ethiopia. The amendment proclamation provides that corruption crimes committed by private sector mainly who administers funds collected from the public or for public purposes get recent recognition.<sup>58</sup> This proclamation goes on to say that the country ratified both UN convention Against Corruption and AU Convention on Preventing and Combating Corruption which levied obligation on the state to inculcate in its laws of



corruption crimes such as bribes, embezzlement, and similar acts committed by private sector.<sup>59</sup>

The new law still does not deal clearly about the crimes of corruption instances with the acts done and commitments performed by founders of share companies. However, the share companies are included under the scope of this law.<sup>60</sup> The focus of the law is mainly on share companies that are in action. The operational part of the law says and uses mainly the term employee of public organization and public enterprises.

#### 4. Conclusion

The presence of a founder entails its own responsibility that the demarcation has to be known among the persons assumed the status of the founder and other staffs who are working at the formation stage of the company. As a result, to decide over the issue who can be entitled the status of the founder is both question of law and fact. In the formation stages of a share company different persons may participate to form a share company. Similarly, wearing one hat a person may be both professional and founder of a company. Furthermore, there are professionals who support founders in the realization of a company under formation. Thus, to give the status of founders for all persons in a company under formation may be against the interests of the coming company.

The exact status of founders among all persons who participate for the formation of a company is somehow difficult in a company formed via public subscription than a company formed among founders themselves. From now, the law is far away to decide over the identity of persons participating in the formation process of share companies.

The law has to be clear about the sources of the capital of a company under formation to launch its business. It is only via public subscription or founders' subscription of the capital or the debt ratio. That means, the source of capital is not appropriately determined in the equity and debt ratio. The Company Law of Ethiopia has to be made an appropriate mechanism in which the vast capital pulled from the public and the tendency of misuse of share companies' establishment process inside the trade societies shall emancipate itself from corrosion.

According to Article 318 of the Commercial Code an offer to subscribers shall be made via prospectus and signed by all founders. The law has provided about the particulars of the prospectus. In practice there is addition and omission of some of the elements of the prospectus from the content provided by the law. It is mandatory to provide the draft copy of the public document under the prospectus. Even, the founders who initiate the original trading activities are seen to contribute cash than contribution in kind. The law has failed to demarcate what kinds of properties to be contributed or not in kind.



Further, the written permission of the Ministry of Trade is needed for the founder to commence the formation process of the company; however, the regulator neglects such rule. Nevertheless, the National Bank of Ethiopia supervises company organizers' personal history and their businesses' soundness, among others. Thus, this bank practically proves the observance of such requirements as procedural formality to be the founder of banking, insurance and other financial businesses.

The regulatory bodies of the government have no appropriate modern technology assistance to ease the licensing and registration of share companies under formation. Thus, there is no easy way to get information and study share companies under formation.

The Company Law and the contracts entered by the founders before formation of a company confer rights and obligations on the founders, third parties and the future company. Furthermore, the Company Law provides mandatory limits of benefits and burdens for the founders in which one can acclaim and be answerable accordingly. Thus, especially the public documents of the company are typical evidences for the existence of an agreement withstanding that their approval by the subscribers' meeting is positive. Nevertheless, the Commercial Code does not define clearly about the commitments entered by the founder and pre contractual dealings among the persons at a company under formation.

The founders or promoters of the company under formation are acting for a company not yet established. The occurrence of conflict of interest is inevitable. There are also legal persons owned by the founders in which they are taking part at a company under formation as promoters of the company. For this reason, the Company Law does not provide appropriate mechanisms to make the founders and other persons answerable. On this regard the Criminal Law is somehow goes in line with the practice. Thus, the disclosure, fiduciary duty and consequences of in-kind contribution valuation procedure have lost place direct consideration under the Company Law of Ethiopia.

In general, the Commercial Code and various legislations that regulate the behaviors of the founders of the share company other than financial laws are not enough to protect the interests of the public. There is no legal mechanism to check about their background to open a new project like National Bank of Ethiopia does such quest as custom in which the founders are asked their past business and ownership history. To add, there is no mechanism to check whether they are convicted or not within certain period of time. These conditions may probably justify their business ethics for protection of the public interests. Furthermore, the National Bank of Ethiopia checks the founders whether they publish the 'Notice of Intention' or not which settle the objection of any third parties lodged to such organ to the effects of the above instances.

The focus of juridical acts at the company under formation period is not only an academic issue, but also a topic of considerable practical significance. It exhibits



the competing interests of third parties, the future company and founders. Thus, the issues in relation to the pre incorporation contracts or commitments entered in to by the founder as per Article 308 of the Commercial Code are all about the discussion of such parties' interests and benefits. Furthermore, this Code does not provide the effects of contractual relationship among the founders. To add, such Code also does not provide the contractual relationship between the legal person and the assigned founder.

The current Company Law of Ethiopia had been made before fifty five years. However, the Commercial Code is still working with some amendments by other laws of the country. To date, it is also the country has in a way to become the member of World Trade Organization. Foreign investors are also working in Ethiopia. Thus, within such purview laws have to be made to compete with changing time. However, Company Law in relation to founders pragmatically justifies that extra reconsideration and rethinking of the law.

In general, Company Law of Ethiopia needs proper amendment of the issues relating to founders of share companies. The harmony of rules on founders of share companies among various enabling legislations, and the Commercial Code over different areas of share companies' businesses should be maintained like the application of the duty to publish notice of intention, by laws of the founders and trade practices history of the founders, which are introduced by the law maker for the working procedure of the National Bank.

Therefore, for the betterment of the legal and policy reform of the Company Law of Ethiopia specially on the share companies formed via public subscription that the writer recommends thorough research to be conducted on this law in general and issues of founders in focus in particular which would guarantee the reengineering of the law and policy on trade and business organization.

#### Foot Notes:

1. BPP Learning Media Ltd, *Fundamentals of Ethics, Corporate Governance and Business Law*, 2010, at 230.
2. See Art. 307(1) and (2) of the Commercial Code of the Empire of Ethiopia (herein after the Commercial Code), Pro. No.166, *Negarit Gazette*, Year 19, No. 3, 1960.
3. Id, Art.307 (3) and (4)
4. Id, Art.307 (3)
5. Id, Art.307 (4)
6. K. R. Bulchanadani, *Business Law*, 2001, at 410.
7. Ibid
8. See Art.310 (1) of the Commercial Code, supra note 2.



9. Ibid
10. Id, Art.310 (2)
11. Id, Art.310(3)
12. The Institute of Company Secretaries of India, *Company Law Module II Paper 4*, 2008, at 78.
13. See Art. 308 (2) of the Commercial Code, supra note 2.
14. Ibid
15. Ibid
16. J. James, *Q & A Series Company Law*, 2003, at 18.
17. See Art.692 (1) of the Criminal Code of the Federal Democratic Republic of Ethiopia (herein after the Criminal Code), Pro. No. 414, *Federal Negarit Gazazette*, 2004.
18. Id, Art. 322 (3).
19. Ibid
20. S.Goulding, *Company Law*, 1999, at 33.
21. Ibid
22. Ibid
23. Id, at 75
24. See Art.692 (1) of the Criminal Code, supra note 17.
25. Ibid
26. See Art. 315(1) of the Commercial Code, supra note 2.
27. See Art.6 (10) of the Commercial Registration and Business Licensing Proclamation (herein after Pro. No. 686/2010), Pro. No. 686, *Federal Negarit Gazette*, Year 16, No. 42, 2010.
28. See Art.339 (1) of the Commercial Code, supra note 2.
29. Id, Art.339 (2)
30. Id, Art.6 (7)
31. Ibid
32. Ibid
33. See Art.12 (5) of Pro. No. 686/2010, supra note 27.
34. Id, Art.12 (5)
35. See Art.4 (1) (c) of Banking Business Proclamation (herein after Pro. No. 592/2008), Pro. No. 592, *Federal Negarit Gazette*, Year 18th, No. 56, 2008.
36. Ibid
37. Ibid
38. Id, Art.4 (2)



39. Ibid
40. Ibid
41. See Art.4 (1) (c) of the Insurance Business Proclamation, Pro. No. 746, *Federal Negarit Gazette*, Year 18, No. 57, 2012.
42. *French Commercial Code English Version, Article L225-2 formation with public offering.*
43. Ibid
44. Id, Art.308 (1)
45. Ibid
46. Id, Art.308(3)
47. Id, Art.309 (1) (a), (b) and (c)
48. Id, Art.309 (2)
49. Id, Art.311 (1)
50. Ibid
51. Id, Art.311 (2)
52. Ibid
53. Id, Art.327
54. Ibid
55. Ibid
56. See Art.60 (2) of Pro. No.686/2010, supra note 27.
57. See Art.58 (7) of Pro. No. 592/2008, supra note 35.
58. Preamble Paragraph 2 of the Corruption Crimes Proclamation, Pro.No.881, *Federal Negarit Gazette*, Year 21, No. 36, 2015.
59. Id, Preamble Paragraph 3
60. Id, Art.2 (4) provides the definition of public organization in which share companies are listed therein.

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